



## ***National Association for the Self-Employed***

---

NASE Legislative Offices • 1200 G Street, NW, Suite 800 • Washington, DC 20005

Phone: 202-466-2100 • Fax: 202-466-2123 • [www.nase.org](http://www.nase.org)

**Testimony of**

**Keith Hall, CPA  
Hall & Hughes, PLLC**

**On behalf of the  
National Association for the Self-Employed**

**Subcommittee on Regulatory Affairs  
House Committee on Government Reform  
“Paperwork Reduction Efforts of the Internal Revenue Service”**

**May 25, 2005**

I would like to express my appreciation to Chairman Candice Miller, Ranking Member Stephen Lynch and the members of this Subcommittee for the opportunity to participate in today's hearing. I am here to testify on behalf of the National Association for the Self-Employed (NASE) and our 250,000 member businesses, representing over 600,000 owners and employees nationwide. The NASE is the nation's leading resource for the self-employed and micro-businesses, businesses with ten or less employees. Today, this vital segment of the small business population is a key driver of America's economic engine and numbers more than 18 million.

Often, the chief speed bump faced by micro-business owners on the road to their success is a collective \$800 billion dollar bill called federal government regulation. And because big successes usually have small beginnings, these costs loom large to micro-businesses, which are capitalized chiefly on dreams and ideas.

The NASE is a strong supporter of an effective, viable Paperwork Reduction Act. This Act, through its authorization of OMB's Office of Information and Regulatory Affairs (OIRA) to review regulations issued by federal agencies, aims to ensure that micro-businesses are not subjected to unreasonable regulations and paperwork. Unfortunately, federal agencies have diluted or worked around this law and continue to issue burdensome regulations without adequately looking at the effect they have on small business. Paperwork for micro-businesses continues to increase and have a detrimental affect on the ability for the self-employed to successfully manage and grow their business. These businesses do not have human resource departments filled with accountants, attorneys or benefits administrators. The self-employed administer every aspect of their business and thus, the time spent addressing onerous regulations is time away from their business.

A report sponsored by the U.S. Small Business Administration entitled "The Impact of Regulatory Costs on Small Firms," cited that firms employing fewer than 20 employees face an annual regulatory burden of \$6,975 per employee. This same report cited that tax compliance issues are particularly burdensome to small business. As a self-employed certified public accountant for 15 years and as a tax consultant for the National Association for the Self-Employed's TaxTalk program, I am in the unique position of conveying to you both my

perspective as a business taxpayer as well as that of a tax professional regarding the regulatory and paperwork burden the IRS places on the self-employed and micro-business.

Let me begin by stating that as a CPA I have been very pleased with the efforts made by the Internal Revenue Service over the past few years to become small business friendly. Positive changes have arisen through the IRS's enhanced outreach and educational efforts as well as their work in the Office of Burden Reduction to simplify and minimize paperwork. Their commitment to their website and the availability of information has been very good and certainly recognized by the NASE and many small business owners.

However, despite steps toward improvement, the IRS in 2005 has estimated that taxpayers will have to spend on average over 19 hours filing a 2004 individual income tax return (Form 1040) and the associated Schedule A. Also, according to a 2001 study conducted by the Joint Committee on Taxation, at that time a taxpayer filing an Form 1040 could be faced with 79 lines on their return, 144 pages of instructions, 19 separate worksheets as well as the possibility of filing numerous other forms. With over 1.4 million words, the tax code is so convoluted that it is extremely difficult for both taxpayers, tax practitioners and the IRS to reliably and accurately comply with or enforce the breadth of tax regulations. Minimizing the complexity of the tax code and paperwork burden faced by small business is one solution that policymakers and taxpayers alike have endorsed.

Through the National Association for the Self Employed TaxTalk service we answer specific personal questions for thousands of small business owners every year. As you might expect, a vast majority of those questions are based on a lack of understanding of some specific point related to their tax compliance. I feel that there are key areas in the tax code that the IRS can address which would greatly minimize the burden on the self-employed.

### **Home Office Deduction**

Increasingly, entrepreneurs are utilizing their home as a primary place of business. According to research commissioned by the SBA Office of Advocacy, home-based businesses represent 52 percent of all firms and provide 10 percent of the total revenue of the economy. Many home-

based business owners do not make use of the home office deduction due to the complexity of the deduction and stringent criteria they must meet.

The form for the home office deduction is very complicated. The taxpayer must differentiate between direct and indirect expenses and also between deductible mortgage interest and excess mortgage interest. Some of the expenses are deductible even if the business has a loss and some aren't. Some casualty losses go on line 9 and some go on line 27. The words "see instructions" appear on this one page form 16 different times. Those instructions say the form will take an average of 1 hour and 15 minutes to complete. The form may be as simple as possible which may indicate that the code is too complicated. The best option for paper work reduction is to concentrate on tax code simplification. A standard deduction for the use of a home office is an excellent example. Providing a tiered deduction based on national averages could save an hour and 15 minutes for many small business owners.

### **Worker classification regulations**

Another specific IRS regulation that is exceedingly burdensome to the micro-business and self-employed communities is the employee vs. independent contractor classification. Many NASE members either utilize independent contractors or are themselves independent contractors. Disputes about who is an employee and who is an independent contractor have cost small businesses more than three-quarters of a billion dollars in IRS penalties and back-taxes during the past 10 years.

The IRS has a complicated 20-point checklist that can be used as a guideline in determining whether or not an individual is an employee or an independent contractor. Yet, using this checklist does not guarantee that a person is correctly classified. Other IRS materials published to assist in classification are equally as convoluted. NASE Members have indicated when utilizing the I.R.S.'s tax assistance help line on this issue, they have gotten different answers from different agents on this same issue. A large issue is that there is no one, single, homogenous definition of the term "employee." Thus, there is no clear and concise manner for a self-employed individual or micro-business owner to easily determine when an individual should be classified as an independent contractor or an employee.

With more and more individuals conducting a business out of their home as "independent contractors" and the economic incentive to employers to use independent contractors rather than employees, the issue of worker reclassification continues to be a key area for the recovery of revenue by the IRS despite its recent efforts to become more small business friendly. Due to the vagueness of existing regulations and their complexity it is very easy for the IRS to arbitrarily reclassify workers and thus, require micro-business owners to pay enormous sums of back taxes and penalties, which can ultimately force them out of business.

The NASE strongly feels that the IRS regulation must be updated to provide straightforward rules for classifying workers and relief from reclassification. A clearly defined set of rules for classification of workers would provide certainty for businesses that enter into independent-contractor relationships, and minimize the risk of huge tax bills for back taxes, interest, and penalties if a worker is misclassified after the parties have entered into an independent-contractor relationship in good faith.

### **Deduction for Business Use of Personal Automobile**

Many self-employed individuals use their personal automobile in the business but don't know how to include that cost on the tax return. They are told that they can fully deduct the cost of the vehicle, but later find out that is true only if the car weighs over a certain number of pounds. Later still they find out the limit is different for SUVs. The IRS has simplified this process with the use of the standard mileage rate. Many small business taxpayers utilize this approach mainly because it is indeed simpler. However, choosing the approach that they can best understand may not be the best tax or business decision for their situation. If they indeed qualify for the section 179 deduction, they can no longer use the standard mileage rate. This is another opportunity for the standard deduction calculation. Having a tiered deduction based on the value of the vehicle in addition to the standard mileage rate for future years would help the small business owner maintain a level playing field with bigger business that have the resources to keep up with the additional reporting requirements. Providing the benefit based on specific fact situations without requiring the completion of additional paperwork will help small business, reduce the level of paper required and would not change overall tax revenue.

### **Other Suggestions to Relating to the Internal Revenue Service**

The NASE encourages Congress to strengthen the Paperwork Reduction Act, most especially the Office of Information and Regulatory Affairs. We believe that OIRA should receive more funding for additional staff and regulation/data review efforts. In addition, the office's oversight authority over independent agencies should be expanded. For example, at the present time the Internal Revenue Service is now chiefly exempt from OIRA oversight. This is a critical impediment to the fulfillment of the goals of OIRA considering that the IRS is the agency whose regulations and paperwork have the most burdensome and widespread affect on small business.

In addition to allowing OIRA some oversight of the IRS, we feel that within the IRS the Office of Taxpayer Burden Reduction should be strengthened through additional funding and staff. This office is responsible for simplifying forms and publications, promoting less burdensome rulings and regulations and streamlining internal IRS policies and procedures. This office has been able to have some significant successes in minimizing and clarifying tax forms and regulations. However, we feel this office is understaffed and under funded to adequately address the extensive scope of IRS regulations.

### **Conclusion**

In conclusion, the ultimate hardship that is faced by the self-employed and micro-businesses when dealing with federal agencies is the complexity, vagueness, and at times redundancy of regulations they issue. The simple difficulty of understanding and then complying with any and all regulations affecting their business is overwhelming for a micro-business owner. This burden imposed on micro-business is disproportionate to that of larger businesses because smaller firms cannot spread the overhead costs associated with hiring accountants and attorneys, and the general cost of paperwork burdens and staff needed to try and comply with the maze of federal regulations.

Thus, we must do a better job through the Paperwork Reduction Act and OIRA to ensure that regulations, specifically those promulgated by the Internal Revenue Service, are reviewed prior to finalization to determine their economic impact and burden on small business. In addition, the

IRS must work harder to minimize and simplify paperwork as well as revise unfair and onerous tax regulations.